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In The

Supreme Court of the United States

CITICORP NORTH AMERICA, INC. & AFFILIATES,

Petitioners,

v.

FRANCHISE TAX BOARD,

Respondent.

On Petition For A Writ Of Certiorari To The Court Of Appeal Of California For The First Appellate District

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

California imposes a franchise tax on all corporations doing business in the State. The measure of the franchise tax is a corporation's income attributable to California sources. When a corporation doing business in California is engaged in a unitary business enterprise with other corporations, and the unitary business does business both in and out of the State, California determines the income attributable to California sources through the unitary business formula apportionment method. This method apportions income by applying a constitutionally-approved three-factor apportionment formula to the business income of the unitary business to arrive at the amount of income of the unitary business attributable to activities within the State. The apportionment factors measure the income attributable to in-state activities by comparing the portion of the group's sales, property and payroll in the State to the total sales, property and payroll everywhere. Once the California-source income of the unitary business has been determined, it is allocated among the individual taxpayer members of the group doing business in the State in proportion to their factors in California. That amount is the measure of each corporation's franchise tax liability. Against this background, the following question is presented:

> May California constitutionally determine the California source income of the taxable members of a unitary group by using an apportionment formula that takes into account the apportionment factors of all members of the group, including the California factors of those group members that are not themselves taxable in the State?

LIST OF PARTIES

Respondent, Franchise Tax Board, accepts the List of Parties as stated by petitioners Citicorp North America, Inc. & Affiliates in the Petition for Writ of Certiorari.

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RESPONDENT'S BRIEF IN OPPOSITION

Respondent Franchise Tax Board ("Board") respectfully requests that this Court deny the Petition for Writ of Certiorari ("Petition") of petitioners Citicorp North America, Inc. & Affiliates (collectively, "Citicorp").

OPINIONS BELOW

The Board accepts Citicorp's statement of the Opinions Below as contained in its Petition and as reproduced at Appendix 1a-85a of the Petition.

STATEMENT OF JURISDICTION

The Board accepts Citicorp's statement of Jurisdiction as contained in its Petition.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Board accepts Citicorp's statement of the Constitutional and Statutory Provisions Involved as contained in its Petition and as reproduced at Appendix 92a-101a of the Petition. Additional statutory provisions are contained in Appendix A of the Board's Brief in Opposition to Petition for Writ of Certiorari.

STATEMENT OF THE CASE

This is an action for refund of California franchise taxes brought by Citicorp, a Delaware corporation and its affiliates located throughout the world, including California. Citicorp is part of a financial services organization engaged in a worldwide unitary business consisting of 550 domestic corporations, 88 of which were California taxpayers during the tax years ending December 31, 1985 through December 31, 1988 ("the years in issue").[1]

A. California's Method of Taxing Corporations Engaged in a Multistate Unitary Enterprise

California imposes a franchise tax on every corporation doing business within the State. Cal. Rev. & Tax. Code § 23151. The measure of that tax is the corporation's net income derived from or attributable to sources within

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[1] A unitary business is a functionally integrated economic enterprise characterized by substantial mutual interdependence and a flow of value among members of the unitary group. *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 178-179 (1983). Flows of value are described as "some sharing or exchange of value not capable of precise identification or sharing or exchange of value not capable of precise identification or measurement – beyond the mere flow of funds arising out of a passive investment or a distinct business operation – which renders formula apportionment a reasonable method of taxation." *Id.* at 166. A business is unitary when sufficient flows of value exist such that "contributions to income [result] . . . from functional integration, centralization of management, and economies of scale." *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 438 (1980), citing *Butler Brothers Stores v. McColgan*, 315 U.S. 501, 508-509 (1942).

California. Cal. Rev. & Tax. Code § 25101. When a corporation conducts business with affiliated corporations as part of a larger unitary business enterprise operating both within and without California, it becomes necessary to determine how much of the income of the unitary business is attributable to sources within California as opposed to another state. In other words, the income of the enterprise must be apportioned between California and other locations in which it conducts business. In these circumstances, business income derived from or attributable to California sources is determined on the basis of the unitary business formula apportionment method.[2] *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 162-163 (1983).

Unitary business formula apportionment is a method of apportioning income in which a business conducted by related corporations as a single economic (unitary) enterprise and which earns income both in and out of California is treated as one unit for determining income attributable to sources within the State. The proportion of the business income of a unitary business attributable to California sources is determined by applying a three-factor apportionment formula, as outlined in the Uniform

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[2] Business income is defined as "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." Cal. Rev. & Tax. Code § 25120(a). In contrast, nonbusiness income is defined as all income other than business income. Cal. Rev. & Tax. Code § 25120(d).

Division of Income for Tax Purposes Act ("UDITPA").[3] Cal. Rev. & Tax. Code §§ 25120-25139.[4]

California's three-factor apportionment formula is comprised of the average of three "factors." The *sales factor* is a fraction, whose numerator is the sales of the unitary group made in California during the year, and whose denominator is the unitary group's sales everywhere. Cal. Rev. & Tax. Code § 25134. The *property factor* is also a fraction, whose numerator is the property owned, rented or used by the unitary group in California during the year, and whose denominator is the group's property everywhere. Cal. Rev. & Tax. Code § 25129. The final factor is the *payroll factor*, whose numerator is the compensation paid in California, and whose denominator is compensation paid everywhere. Cal. Rev. & Tax. Code § 25132. The numerator of each of these three fractions or "factors" represents the value of sales, property or payroll of the unitary group within California, and the denominator of each fraction represents the value of sales, property or payroll of the group everywhere. For the years in issue, the apportionment factor was determined by adding the sales, property, and payroll factors and dividing by three.[5] Cal. Rev. & Tax. Code § 25128.

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[3] UDITPA was enacted in California in 1966 and has been adopted by over 20 states.

[4] Under regulations promulgated under authority of Cal. Rev. & Tax. Code § 25106.5, corporations engaged in a unitary business are required to file a "combined report" for the purpose of determining the amount of business income of the unitary group attributable to California sources.

[5] Section 25128 was amended, effective for taxable years beginning on or after January 1, 1994, to double-weight the sales

The apportionment factor is then applied to the world-wide business income of the unitary group to determine the amount of business income attributable to California sources.

Once the business income of the unitary group is apportioned by formula to California under combined reporting principles, the tax status of each California taxpayer member of the unitary group as a separate and distinct legal entity is taken into account. The income attributable to California sources is allocated among the individual members of the unitary group that are California taxpayers in proportion to each corporation's factors in California. This process is required so that each taxpayer's income attributable to California sources can be determined in arriving at its franchise tax liability.

This Court has observed that California's three-factor apportionment formula has not only "met our approval" against constitutional challenge made under the Due Process Clause and the Commerce Clause, but has become "something of a benchmark against which other apportionment formulas are judged." *Container Corp.*, 463 U.S. at 170.

B. California's Method of Computing the Factors of Its Apportionment Formula

The dispute in this case involves the method by which California determined Citicorp's California sales

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factor. Thus, the apportionment factor is currently determined for most taxpayers by adding the sales factor twice, the property factor and the payroll factor and dividing by four.

under the State's three-factor apportionment formula during the years in issue. Under California law, sales are generally assigned for apportionment purposes to the state of their destination if the "taxpayer" is subject to taxation in that state. Cal. Rev. & Tax. Code § 25135. However, if the "taxpayer" is not taxable in the state of destination, the sales are "thrown back" to the state of origin. Thus, if a "taxpayer" ships property from another state to a purchaser in California, and the "taxpayer" is taxable in California, the sale is considered to be a sale in California and is included in the numerator of the sales factor. On the other hand, if the "taxpayer" is not taxable in California, the sale is "thrown back" to the state of origin and deemed to be a sale outside California – and thus excluded from the numerator of the sales factor – for apportionment factor purposes.[6] The throwback rule arises from the fundamental premise of unitary business formula apportionment that all, but not more than all, of the income of a unitary business enterprise should be subject to taxation in the jurisdictions in which it does business.

For the years in issue, California determined that for purposes of apportionment, the term "taxpayer," as used

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[6] Cal. Rev. & Tax. Code § 25135 applies to the sale of tangible property. Although intangible property is generally not included in the sales factor, California regulations specially provide that banks and other financial institutions such as Citicorp are required to include intangible property, such as credit card receivables, in both their sales *and* property factors in accordance with statutory and regulatory provisions for the assignment of tangible property. 18 Cal. Code of Regs. § 25137-4 (now renumbered 25137-4.1).

in Cal. Rev. & Tax. Code § 25135, referred not to the individual member of the unitary group which made the sale, but rather to the seller's unitary group as a whole. *Appeal of Finnigan Corporation*, Cal. State Tax Rptr. (CCH) 1986-1990 transfer binder, ¶ 401-797 (August 28, 1988); *Appeal of Finnigan Corporation* on rehearing, Cal. State Tax Rptr. (CCH) 1986-1990 transfer binder ¶ 402-524 (January 24, 1990). Accordingly, a sale made by a California seller to a purchaser in another state (*i.e.*, an "outbound sale") could not be thrown back to California if any other member of the seller's unitary group was taxable in the destination state, irrespective of whether the individual seller corporation was itself taxable there. Rather, that sale was treated as a sale in the state of its destination under section 25135 and excluded from California's sales factor numerator. Conversely, a sale made by an out-of-state seller **into** California (*i.e.*, an "inbound sale") could not be thrown back to the state of origin, even if the individual seller corporation was not taxable in California, if any other member of the seller's unitary group was taxable in the State.[7] *Appeal of the NutraSweet Company*, Cal. State Tax Rptr. (CCH) 1992-1993 (Pt. 2) transfer binder ¶ 402-524 (October 29, 1992).

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[7] As will be discussed later, California has, since 1999, returned prospectively to a previously-used method of attributing unitary business income to the State which excludes from the apportionment formula the California factors of group members not taxable in the State.

C. California's Computation of Citicorp's California Sales for Apportionment Purposes

Citibank (South Dakota), N.A. ("Citibank South Dakota"), a member of Citicorp's unitary business during the years in issue, issued Visa and MasterCard credit cards. Citibank South Dakota had no physical presence (*i.e.*, tangible property or payroll) in California and was not subject to California franchise tax. However, Citibank South Dakota generated hundreds of millions of dollars in California sales receipts and credit card receivables to credit cards customers in California during each of the years in issue.

For each of the years in issue, Citicorp originally filed California franchise tax returns on a separate company basis. Citicorp later filed amended returns for each of the years in issue, taking the position that it engaged in a worldwide unitary business. Consequently, Citicorp determined its income attributable to California sources, and ultimately, its franchise tax liability on the basis of the California three-factor apportionment formula. The amended returns, which constituted claims for refund, sought tax refunds for each of the years in issue. Citicorp took the position in its amended returns that the value of the credit card sales and property generated by Citibank South Dakota to California customers should be excluded from the numerators (California factors) of the three-factor apportionment formula because Citibank South Dakota was not taxable in California.

The Board accepted Citicorp's amended position that it was engaged in a unitary business, but determined that the California sales (credit card receipts) and property

(credit card receivables) of Citibank South Dakota should be included in the numerators of the three-factor apportionment formula. Accordingly, the Board increased the numerator of Citicorp's sales factor by adding Citibank South Dakota's sales receipts from California credit card customers in the following amounts: $253,377,191 for 1985, $350,520,156 for 1986, $396,321,750 for 1987 and $478,974,131 for 1988. The Board also increased the numerator of Citicorp's property factor by adding Citibank South Dakota's credit card receivables from California customers in the following amounts: $1,364,590,734 for 1985, $1,694,273,294 for 1986, $2,303,098,005 for 1987 and $3,187,824,161 for 1988. This resulted in an increase in the apportionment of Citicorp's unitary group income to California by the following amounts: $12,826,406 for 1985, $11,558,073 for 1986, $9,083,509 for 1987 and $14,705,509 for 1988.

As a consequence, Citicorp's claims for refund were only partially granted. The portion of the claims for refund attributable to the exclusion of Citibank South Dakota's California sales and property from the apportionment factor numerators was denied.

D. Adjudication of the Federal Questions in the Proceedings Below

As a result of the Board's actions, Citicorp filed suit for a tax refund in the San Francisco County Superior Court. Citicorp alleged, in part, that California's method of apportioning income resulted in the unconstitutional taxation of the income of a nontaxable member (Citibank South Dakota) of its unitary business, in violation of the

Due Process Clause and the Commerce Clause of the United States Constitution. The trial court ruled that California's method of apportioning the sales of a corporation engaged in a unitary business was constitutional and rendered judgment in favor of the Board. Appendix 49a-84a of Petition.

Citicorp appealed. By unanimous decision, a three-member panel of the California Court of Appeal affirmed the judgment of the trial court. Appendix 1a-48a of Petition. The Court of Appeal rejected Citicorp's claim that California's apportionment method resulted in the indirect taxation of the income of Citibank South Dakota and concluded that California was actually imposing taxes "only on the corporations that are subject to California's taxing jurisdiction." Appendix 14a of Petition.

> Citibank (South Dakota) is not being subjected to a tax in this case. The relevant stipulated fact in this case is that Citicorp and its affiliates, including Citibank (South Dakota) "were conducting a worldwide unitary business during the years in issue, and their combined franchise tax liability must be computed on a unitary basis." The rule applied here results in recognition that the unitary group benefitted from sales in California.

Appendix 18a of Petition. Accordingly, the Court of Appeal found California's apportionment method to be "consistent with accepted principles of taxation of a unitary business." Appendix 15a of Petition. Furthermore, the Court of Appeal determined that Citicorp had failed to carry its burden of demonstrating that California's approach to attributing sales to California under its

apportionment formula violated either the Due Process Clause or the Commerce Clause. Appendix 29a-33a of Petition.

> There is nothing arbitrary or unconstitutional about assigning Citibank's (South Dakota) credit card sales and transactions actually occurring in California to California. Such an assignment reasonably recognizes the contribution of the state in producing the income of the unitary group. Citicorp has not shown the allocation to California is " 'out of all appropriate proportions to the business transacted . . . in that State. . . . ' " (*Container Corp. v. Franchise Tax Bd., supra,* 463 U.S. at p. 170.)

Appendix at 33a of Petition.

Citicorp sought review of the Court of Appeal's decision in the California Supreme Court. Without comment, the California Supreme Court denied Citicorp's petition for review. Appendix 85a of Petition.

REASONS FOR DENYING THE PETITION

This Court should deny review of the California Court of Appeal's decision affirming the validity of California's apportionment method for determining income of the taxable members of a unitary business attributable to California sources. Several reasons compel this conclusion.

First, Citicorp's arguments raise issues which have no ongoing legal significance in California. As of April 22, 1999, California has reverted prospectively to using a

previously-used apportionment method in which the California sales, property and payroll of nontaxable members of a unitary business, including Citicorp, are no longer attributed to California for purposes of computing the numerators of the group's sales, property and payroll factors.

Second, Citicorp's claim is a thinly-disguised attempt to undermine decades of authority from this Court permitting a taxing state to look beyond its borders to arrive at a fair allocation of its share of the taxable values of a taxpayer's activities within the state. Citicorp is undisputedly engaged in a unitary business. This Court has repeatedly and consistently rejected the contention that a state that takes into consideration for apportionment purposes the activities of nontaxable members of the unitary group is engaged in extraterritorial taxation. Citicorp's petition reflects a fundamental misapprehension between two distinct and separate concepts: a state's right to *apportion* the income of a unitary business to determine the proper state source of that income and a state's *jurisdiction* to tax individual corporations.

Third, Citicorp's position is based on the false premise that the separate identity (and thus, the separate income) of the individual members of a unitary group, such as Citibank South Dakota, should ultimately determine the group's collective tax liability. This premise is contrary to the fundamental unitary business principle that, for purposes of apportioning the appropriate share of the group's unitary business income to a state, the separate identity of the individual members of the unitary group may be ignored, because separate accounting

does not and cannot adequately reflect the many contributions to income and flows of value among members of a unitary group. Combined reporting operates on the constitutionally-approved principle that the income of the *entire* unitary group of corporations, and the group's factors, may be considered when apportioning income to the taxing state.

I. THE ISSUE BEFORE THIS COURT LACKS SUFFICIENT IMPORTANCE TO WARRANT A GRANT OF REVIEW

At the outset, certiorari should be denied because the issues raised in the Petition have no ongoing legal significance in California. As of April 22, 1999, California administratively changed, on a prospective basis, its method of assigning sales to the State by returning to a previously-used apportionment method, one in which the California sales, property and payroll of nontaxable unitary members are no longer attributed to California in computing the numerators of the group's sales, property and payroll factors. 18 Cal. Code of Regs. § 25106.5(c)(7)(B). Thus, for corporations doing business in the State, including Citicorp, the implications of the California Court of Appeal's decision have little, if any, ongoing impact. Citicorp's petition raises questions applicable only to the years in issue, already resolved twice in favor of California, and with little significance outside the limits of this case. Therefore, certiorari should be denied.

In any case, Citicorp misstates the significance of the California Court of Appeal's decision by characterizing it as "a serious threat to constitutional restraints on state

taxation." Petition at 22. In reality, what Citicorp seeks is to significantly erode many decades of decisional authority from this Court permitting a taxing state to look beyond its borders to arrive at a fair allocation to the state of a fair share of the taxable values of the taxpayer's activities within the state. *See, e.g., Barclays Bank PLC v. Franchise Tax Bd. of Cal.*, 512 U.S. 298, 311-12 n. 10 (1994); *Shell Oil Co. v. Iowa Dep't of Revenue*, 488 U.S. 19, 30-31 (1988); *Container Corp., supra*, 463 U.S. at 165; *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207, 219 (1980); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 436 (1980); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978); *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 460 (1959). *See generally International Harvester Co. v. Evatt*, 329 U.S. 416 (1947); *Butler Brothers Stores v. McColgan*, 315 U.S. 501 (1942); *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123 (1931); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271 (1924); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920).

Never before in the history of state apportionment of income cases before this Court has a taxpayer successfully contended that a state's inclusion of the nontaxable income of a unitary group member, generated as part of the unitary business, in the apportionable income base of a unitary group member resulted in extraterritorial taxation. None of the cases cited by Citicorp that invalidated state exactions of extraterritorial income involved the apportionment of income of a unitary business or, more specifically, the prohibitions against a state considering, in the apportionment process, the activity and income of corporations whose connection to the taxing

state was that they were part of a unitary business operating there.[8] This Court has uniformly rejected such a notion on the ground that the apportionment of income is not tantamount to the taxation of income.

For instance, in *Shell Oil Co.*, 488 U.S. at 30-31, this Court upheld the inclusion in the State of Iowa's tax base of income generated from the Outer Continental Shelf and rejected an argument – that the inclusion of nontaxable income in the apportionable base of a state's tax results in the taxation of extraterritorial values – similar to that presented here:

> Shell's argument hinges on the mistaken premise that including OCS-derived income in the preapportionment tax base is tantamount to the direct taxation of OCS production. But income that is included in the preapportionment tax base is not, by virtue of that inclusion, taxed by the state. Only the fraction of total income that the apportionment formula determines (by multiplying the income tax base by the apportionment fraction) to be attributable to Iowa's

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[8] For example, in this Court's recent decision in *Hunt-Wesson, Inc. v. Franchise Tax Board*, 528 U.S. 458 (2000), the issue presented did not involve the proper apportionment of income of a unitary business doing business in California. Rather, the case involved the constitutionality of California's "interest offset deduction," (Cal. Rev. & Tax. Code § 24344), which, *after the apportionment of income to individual taxpayers*, operated to assign the interest expense deduction of a corporation as a deduction against nonbusiness income. This Court held that this assignment, as applied to out-of-state taxpayers whose nonbusiness income was not taxable in California, caused extraterritorial income to be taxed indirectly by the State in violation of the Due Process Clause.

> taxing jurisdiction is taxed by Iowa. As our Commerce Clause analysis of apportionment formulas has made clear, the inclusion of income in the preapportioned tax base of a state apportionment formula does not amount to extraterritorial taxation. This court has repeatedly emphasized that the function of an apportionment formula is to determine the portion of a unitary business' income that can be fairly attributed to instate activities. *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207, 219 (1980); *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 440 (1980).

It follows implicitly from these decisions that where, as here, income apportioned to the State is increased by consideration of the income and factors (such as sales to California customers) of the nontaxable members of the group, any increase in the tax base is properly borne by the taxable corporations. The combined reporting process utilized by California reflects the values in the State of the integration and interdependence of the taxable and nontaxable members of Citicorp's unitary business. Granting certiorari to affirm, yet again, what has long been a fundamental principle of state taxation law is unwarranted.

II. THIS COURT SHOULD DENY REVIEW BECAUSE THE CALIFORNIA COURT OF APPEAL'S DECISION IS FULLY CONSISTENT WITH THE WELL-SETTLED DECISIONS OF THIS COURT

A. California's Method of Apportioning Unitary Business Income to Its California Source Does Not Implicate the State's Jurisdiction to Tax Under the Due Process Clause or Commerce Clause

Citicorp attempts to make the case that California's apportionment method – which attributed to the State the credit card sales to California customers of a nontaxable member of Citicorp's unitary business, thereby increasing the tax base of Citicorp's members taxable in California – resulted in extraterritorial taxation. To the contrary, California's method of apportionment is fully consistent with constitutionally-approved principles of apportioning income for the purposes of taxation of the members of a unitary business.

Citicorp's attack on California's apportionment method suffers from two critical misconceptions.

First, it confuses a state's *jurisdiction* to tax with *apportionment* of income. Citicorp's contention that California's apportionment of income to its taxable members results in extraterritorial taxation solely because sales to California customers are made by a nontaxable member of the unitary business is contrary to the long line of well-established precedents of this Court approving the apportionment of income of unitary business enterprises. These decisions have consistently affirmed the fundamental unitary business principle that in apportioning the combined income of a unitary group of corporations, a state is

not constitutionally barred from taking into account the income and factors of all the members of the group, without regard to whether the members are subject to tax by the state.

> This method [unitary business formula apportionment], unlike separate accounting, does not purport to identify the precise geographical source of a corporation's profits; rather, it is employed as a rough approximation of a corporation's income that is reasonably related to the activities conducted within the taxing State.

Moorman Mfg. Co., 437 U.S. at 273. *See also Barclays Bank*, 512 at 311-12 n. 10; *Shell Oil Co.*, 488 U.S. at 30-31; *Container Corp.*, 463 U.S. at 165; *Exxon Corp.*, 447 U.S. at 219; *Mobil Oil Corp.*, 445 U.S. at 436; *Northwestern States Portland Cement Co.*, 358 U.S. at 460. *See generally Butler Bros.*, 315 U.S. 501; *Hans Rees' Sons*, 283 U.S. 123; *Underwood Typewriter Co.*, 254 U.S. 113. In so holding, this Court has declared that a "state's tax law is not to be nullified merely because the result is achieved through a formula which includes consideration of interstate and out-of-state transactions in their relation to the intrastate privilege," (*International Harvester Co.*, 329 U.S. at 423), and that in imposing an apportioned tax on doing business, a state may look "to the property of such corporations beyond its borders. . . . " *Bass, Ratcliff & Gretton, Ltd.*, 266 U.S. at 282.

The decision of the California Court of Appeal is fully consistent with these well-established decisions. In rejecting Citicorp's claim that California's attribution of Citibank South Dakota's sales to California in the apportionment formula results in extraterritorial taxation, the

Court of Appeal held that the State "is not taxing, but is apportioning income attributable to California. (*Edison California Stores v. McColgan, supra,* 30 Cal.2d 472, 474-475.) Taxes are actually imposed only on the corporations that are subject to California's taxing jurisdiction." Appendix 14a of Petition. California's attribution of Citibank South Dakota's credit card sales to California customers to the State "results in recognition that the unitary group benefitted from sales in California." Appendix 18a of Petition.

Second, Citicorp's attack on California's apportionment method is fatally flawed because it is based on the premise that the separate identity (and thus, the separate income) of individual members of its unitary group, such as Citibank South Dakota, should ultimately control the determination of the group's collective tax liability. In order to repeatedly complain that California's apportionment method results in the "shifting" of income from a nontaxable corporation to taxable corporations, Citicorp must necessarily segregate the income of its unitary business enterprise into the separate income of each of the individual member corporations. This segregation can only be accomplished through the mechanism of separate accounting, which this Court has held "is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise." *Container Corp,* 463 U.S. at 164-165. Thus, Citicorp's argument disregards the undisputed fact that each of its unitary members, whether taxable or nontaxable in the State, constitutes an integrated part of a single unitary enterprise.

The premise of Citicorp's argument is fundamentally at odds with the underlying theory of unitary business formula apportionment as reflected in California's system of combined reporting: the separate identity of the individual members of the unitary group is disregarded for the purpose of determining the appropriate amount of the unitary group's combined income to apportion to the taxing state. *See Mobil Oil,* 445 U.S. at 439 ["the linchpin of apportionability in the field of state income taxation is the unitary business principle"]. Under combined reporting principles, the income and factors of the entire unitary group, not solely its taxable members, are properly considered in making that determination, because a state may tax a proportionate share of the "unitary" income of a nondomiciliary corporation that carries out a particular business both in and out of that state. *Allied-Signal v. Director, Division of Taxation,* 504 U.S. 762, 778 (1992). Thus, as the California Court of Appeal correctly observed in this case, the attribution of Citibank South Dakota's "credit card sales and transactions actually occurring in California to California . . . reasonably recognizes the contribution of the state in producing the income of the unitary group." Appendix 33a of Petition.

Simply put, California's apportionment method neither "shifts" nor "assigns" anything to or from one corporation to another or from one state to another. It merely apportions to the State a portion of Citicorp's unitary business income which reasonably approximates the level of business conducted by the unitary group in the State, *i.e.,* determines the income of the unitary group attributable to California sources. Income attributable to California sources, which is the measure of a corporation's tax

liability under California statutes, is then assigned to the members of Citicorp's unitary business taxable in the State.

Citicorp is undisputedly engaged in a unitary business. Because its business is not truly separate and distinct from the operations of the unitary group in California, its income may not be segregated clearly and accurately from its California operations. Thus, as the California Court of Appeal properly concluded, Citicorp's credit card sales to its California customers, regardless of the taxable or nontaxable status of the individual member of the unitary group that carries it out, may be appropriately considered in determining the appropriate amount of Citicorp's income that is attributable to California sources.

B. California's Apportionment Method Does Not Violate the Commerce Clause by Favoring In-State Over Out-Of-State Entities

Citicorp's allegation that California's apportionment method discriminates against interstate commerce is constructed on the same faulty premise as its allegation of extraterritorial taxation. By inappropriately ascribing its unitary business income to individual members of its unitary group, such as Citibank South Dakota, in an apportionment setting, Citicorp once again ignores fundamental principles of combined reporting and reverts to the separate accounting principles which this Court has previously rejected. *Container Corp.*, 463 U.S. at 164-165. Little, if anything, needs to be added to the Board's

previous response: the tax liability of a group of corporations engaged in a unitary business both within and without the state is appropriately measured not by reference only to the taxable status of individual members of the unitary business, but rather, by reference to the activities of the entire unitary group through the use of an objective three-factor apportionment formula that "has become . . . something of a benchmark against which other apportionment formulas are judged." *Id.* at 170.

California's method of apportionment does not discriminate against interstate commerce, because the measure of the State's franchise tax does not depend on the state where a corporation is domiciled or conducts its business. To illustrate, during the years in issue, California treated "inbound sales" to the State in exactly the same manner as "outbound sales" from the State, *i.e.*, sales were not "thrown back," or attributed to their state of origin when any member of the unitary group was taxable in the state of destination. Consequently, when this apportionment method was applied to "outbound sales," it actually had the effect of *reducing* the income base of the taxable members of the group taxable in California.

Citicorp's reliance on *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996) is misplaced. The state taxing scheme condemned in that case did not arise in the context of the apportionment of income of a unitary business doing business in the state. Moreover, the attribution to California of the credit card sales to California customers made by Citibank South Dakota was not the result of its nontaxable status. Under California's apportionment method,

the credit card sales would have been included in Citicorp's California sales numerator regardless of the taxable or nontaxable status of Citibank South Dakota.

This Court has observed that "[a]t least in the interstate commerce context . . . the anti-discrimination principle has not in practice required much in addition to the requirement of fair apportionment." *Container Corp.*, 463 U.S. at 171. No "penalty" of nontaxable members of a unitary business is inherent in California's methodology.

C. California's Apportionment Method Fairly Approximates Citicorp's Level of Unitary Business Activity Within the State

California's apportionment method does not violate the Commerce Clause requirement of fair apportionment by "shifting" the income of a nontaxable corporation to a taxable corporation. Once again, by attempting to attach income and apportionment factors to individual members of an integrated unitary business enterprise, Citicorp inappropriately injects separate accounting principles into the apportionment process. In so doing, Citicorp ignores the basic purpose and rationale of apportionment.

On the most fundamental level, there is nothing arbitrary or unfair about attributing Citicorp's credit card sales made in *California* and to *California* customers to *California*. Including such sales in the California based numerators of the apportionment formula reasonably reflects how income is generated in the State. Citicorp's contention that the unitary business income apportioned to California was out of all appropriate proportion to its

activities in California is demonstrably false: although credit card sales receipts to Citibank South Dakota from California customers during the years in issue ranged from over $253 million to in excess of $478 million and credit card receivables from California customers ranged from over $1.3 billion to over $3.1 billion, the additional unitary income apportioned to the State increased only by amounts ranging from approximately $9 million to less than $15 million. The California Court of Appeal properly found that Citicorp had failed to present any evidence at trial to support its allegation that California's apportionment scheme grossly distorted the amount of unitary business income allocable to California. Appendix 31a of Petition. On the contrary, the Court of Appeal concluded, "the evidence reflected the reasonable apportionment of sales generated in California." Appendix 31a of Petition.

Including sales in California's apportionable tax base notwithstanding that the individual seller (Citibank South Dakota) in Citicorp's unitary group was not itself taxable in California is the apportionment method that is most consistent with the fundamental theory of unitary business formula apportionment. While a state is perfectly free to exclude consideration of such sales in the determination of its apportionable income base, as California has done prospectively, there is no provision in the Constitution that requires it to do so. If the sales of Citibank South Dakota must be excluded from the apportionable income base under the Constitution, it would follow that all sales of goods to a state by a member of a unitary group that is nontaxable in the destination state would have to be excluded from the numerator of the

state's sales factor. Such a result would hardly reflect a reasonable apportionment of income among the jurisdictions in which the unitary business conducts its activities which, after all, is the ultimate goal of formula apportionment. Indeed, it would have just the opposite effect. More importantly, Citicorp has failed to cite a single authority interpreting the limitation on the states' powers of taxation in this manner.

CONCLUSION

For all of the foregoing reasons, the petition for writ of certiorari should be denied.

Respectfully submitted,

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APPENDIX A

RELEVANT CALIFORNIA STATUTES

Cal. Rev. & Tax Code § 23151 (1997)

§ 23151. Imposition and rate of tax

(a)With the exception of banks and financial corporations, every corporation doing business within the limits of this state and not expressly exempted from taxation by the provisions of the Constitution of this state or by this part, shall annually pay to the state, for the privilege of exercising its corporate franchises within this state, a tax according to or measured by its net income, to be computed at the rate of 7.6 percent upon the basis of its net income for the next preceding income year, or if greater, the minimum tax specified in Section 23153.

(b) For calendar or fiscal years ending after June 30, 1973, the rate of tax shall be 9 percent instead of 7.6 percent as provided by subdivision (a).

(c) For calendar or fiscal years ending in 1980 to 1986, inclusive, the rate of tax shall be 9.6 percent.

(d) For calendar or fiscal years ending in 1987 to 1996, inclusive, and for any income year beginning before January 1, 1997, the tax rate shall be 9.3 percent.

(e) For any income year beginning on or after January 1, 1997, the tax rate shall be 8.84 percent. The change in rate provided in this subdivision shall be made without proration otherwise required by Section 24251.

Cal. Rev. & Tax Code § 25101 (1982)

§ 25101. Basis of Allocation

When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with Section 25120). However, any method of apportionment shall take into account as income derived from or attributable to sources without the state, income derived from or attributable to transportation by sea or air without the state, whether or not the transportation is located in or subject to the jurisdiction of any other state, the United States or any foreign country.

If the Franchise Tax Board reapportions net income upon its examination of any return, it shall, upon the written request of the taxpayer, disclose to it the basis upon which its reapportionment has been made.

Cal. Rev. & Tax Code § 25135 (1966)

§ 25135. Determination of sales in this state of tangible personal property for inclusion in sales factor

Sales of tangible personal property are in this state if:

(a) The property is delivered or shipped to a purchaser, other than the United States government, within this state regardless of the f.o.b. point or other conditions of the sale; or

(b) The property is shipped from an office, store, warehouse, factory, or other place of storage in this state and (1) the purchaser is the United States government or (2) the taxpayer is not taxable in the state of the purchaser.